



**STATE OF TENNESSEE
DEPARTMENT OF FINANCE AND ADMINISTRATION
STATE CAPITOL
NASHVILLE, TENNESSEE 37243-0285**

**JOHN D. FERGUSON
COMMISSIONER**

December 10, 1999

The Honorable Don Sundquist
Governor of the State of Tennessee

I am pleased to submit the Comprehensive Annual Financial Report of the State of Tennessee for the fiscal year ended June 30, 1999. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures, rests with the state. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds and account groups of the state. All disclosures necessary to enable the reader to gain an understanding of the state's financial activities have been included.

The Comprehensive Annual Financial Report is presented in three sections: introductory, financial and statistical. The introductory section includes this transmittal letter and the state's organizational chart. The financial section includes the general-purpose financial statements and the combining and individual fund and account group financial statements and schedules, as well as the auditor's report on the general-purpose financial statements. The statistical section includes selected financial and demographic information, generally presented on a multi-year basis.

The financial reporting entity of the state includes all the funds and account groups of the primary government as well as all its component units. Component units are legally separate entities for which the primary government is financially accountable. The government provides a full range of services including education, health and social services, transportation, law, correction, safety, resources and regulation, and business and economic development.

ECONOMIC CONDITION AND OUTLOOK

The state's economic diversity has improved substantially over the last several years. Investments announced in new and expanding manufacturing businesses exceeded one billion dollars every year since 1983, and exceeded two billion dollars in the last seven years. Announced manufacturing capital investments in 1998 were \$3.3 billion. This growth has created 23,103 new jobs in this year alone, and has had a positive effect on employment and the state's economy. Additionally, investments in headquarters, distribution and selected services grew to \$1.8 billion in 1998. For June 1999, the state unemployment rate of 3.6% was under the national average of 4.5%. The financial impact of these events is presented later in this letter. Based on current projections, the state's overall growth is expected to exceed the national average into the next century. While having a positive impact, this growth also presents significant challenges for the state. If the present level of services is to be maintained and an ambitious program for major improvements in the educational system is to continue to be implemented, the state must continue to conservatively manage its financial resources.

Tennessee's economy has remained strong the last five years and is in an expansion period. Tennessee's state government has taken appropriate steps to ensure that the state is able to successfully manage its finances in the future.

MAJOR INITIATIVES

For the year. The Administration produced a budget to fund the daily operations of state government and its new initiatives along with a proposed new tax structure for Tennessee. The proposed tax structure would have lessened the budget's reliance on a state sales tax. While the legislature did not enact the proposed tax structure, it did provide continued funding for all necessary programs. The tax reform debate continues.

The Administration's strategic planning process, begun in 1997, has continued to be refined. The process includes organizational self-assessment, goal setting, strategy development and performance monitoring. Each state department developed their own departmental strategic plan aligned with the statewide strategic plan. These plans become the foundation for departmental budget requests and assist in prioritizing information systems development projects. As a result of the planning process, key systems projects were identified and funded. Two departments, the Department of Labor and the Department of Employment Security were merged into one to deliver better service through improved coordination.

The Administration's first goal is to create a more effective, efficient and focused state government. The Office of Information Resources (OIR) contracted the service delivery of the state's telecommunications network to improve functionality, capacity and efficiency. Financial managers continued to work on accounting processes to improve the timeliness of recording accounting transactions and work began on a financial data warehouse. The Division of Accounts began a systems project to streamline the employee travel and expense process to reduce overhead costs associated with reimbursements. The Department of Finance and Administration worked with the Department of Human Services to privatize the centralization of child support collections. Also, during the year these departments worked together to implement an electronic benefit transfer (EBT) system. The system uses ATM-like cards that are issued to over 275,000 families instead of welfare checks and food stamps. The EBT system provides additional security against fraud, theft and abuse. The Administration also consolidated administrative functions for TennCare and TennCare Partners' Program creating greater efficiencies, particularly in data collection. A new TennCare encounter reporting system was developed to improve the quality of program monitoring. OIR continued its organized approach to Y2K remediation. All departments worked on business contingency planning to ensure uninterrupted service to citizens.

Another initiative is to offer every Tennessee child a safe, healthy start. Each day more and more families across the economic spectrum place a child in childcare. Childcare is a valuable option that expands parents' education, job training and career choices. Long term research demonstrates that quality childcare can ameliorate the conditions of children considered "at risk" for future problems because of unstable family life, poverty, or other barriers. Over the last few years, Tennessee has made substantial strides in expanding and improving childcare. The Department of Human Services has raised safety standards, increased childcare center staff training requirements and improved the standards for nutrition. There are approximately 4,867 licensed childcare providers serving over 267,000 children in Tennessee. Since 1996 some 800 new licensed facilities have opened. Today 52,000 children receive some subsidy for childcare. Within the Department of Children's Services residential placement contracts have been redesigned to emphasize permanency for children through adoption, reunification or independent living. A new computer system called TnKids has been developed to allow caseworkers all over the state to access information about a child's care. The system won a national award in 1998 from the National Association of State Information Resource Executives.

Another priority is to create excellence in education. The Administration has funded the Basic Education Program (BEP). The BEP funds each school system to provide a basic level of service for all students in Tennessee. The plan provides funds to local school systems based on their student membership, costs of certain educational components, and the community's relative ability to fund education. All Tennessee schools and libraries are also connected to the Internet through an initiative called ConnecTen. Through this effort, Tennessee has the unique distinction of having nearly 900,000 students on a consolidated, standardized and reliable network with 95,000 computers on-line. Also, Tennessee's School Safety Center helps to make schools safe for teaching and learning. The center has helped by training teachers in conflict resolution, mediation and negotiation through the Peaceable Schools Program. Tennessee has launched a major effort to teach and encourage young people to enjoy reading independently by the time they complete third grade. In partnership with a Tennessee publisher, 300,000 books were provided to Tennessee children. The Education Edge system is also an initiative that blends higher academic standards with new ways for students to gain information and experience they need to pursue the careers of their choice. State initiatives are also under way to create comprehensive career development in seven areas and to review and upgrade the common core of courses all students take in high school.

To create a climate for good, high paying jobs, the Administration has placed emphasis on workforce development through adult basic education, job retraining and better-coordinated job placement efforts. Legislation was passed which integrated the Departments of Labor and Employment Security, Tennessee Career Centers, Office of Workforce Development, Adult Basic Education for the Department of Education and the employment and training component of the Food Stamp Program of the Department of Human Services. The new department is called the Department of Labor and Workforce Development. Also, the Department of Transportation and the Department of Economic and Community Development have worked together on infrastructure issues associated with the Dell Corporation development in Tennessee.

To protect public health and safety, the Administration has made important strides in health care and used a coordinated effort to prepare for contingencies. The Department of Health continued its work in the Tennessee Adolescent Pregnancy Prevention Program by providing information to over 400,000 youth and launching a statewide initiative for intensive case management and referral services for high-risk youths. School and community-based education related to drug abuse, tobacco use and violence prevention was provided to over 30,000 students. In relation to preparation for Y2K contingencies, departments associated with public safety coordinated their contingency plans. The group consisted of the Department of Safety, the Tennessee Emergency Management Agency, the Department of Correction, the Tennessee Bureau of Investigation, the Department of Military, the Department of Veteran's Affairs and the Board of Pardons and Paroles. Other state agencies report coordinating information to the group as well. These agencies are the Department of Health, the Department of Environment and Conservation, the Department of Agriculture, the Department of Children's Services, the Tennessee Regulatory Authority and the Department of Finance and Administration.

For the Future: As with any strategic planning process for large organizations, work continues from year to year on established goals. The initiatives identified here reflect the issues facing Tennessee today. Continuing in this endeavor, these major initiatives will remain in the forefront of Tennessee State Government in the future.

Departmental Focus. The Department of Finance and Administration was created by the Reorganization Act of 1959. Prior to this Act, the financial operations of state government were handled by staff divisions of the governor's office. Currently, the divisions of the department include the Divisions of Administration, Center for Effective Government, Division of Budget, Office for Information Resources, Insurance Administration, Division of Accounts, Resource Development and Support and Capital Projects/Real Property Management. Primary responsibilities include preparing of the state's annual budget, managing the statewide telecommunications and data processing network, providing health insurance for state, local government and local education employees, maintaining the state's accounting records, preparing of the comprehensive annual financial report, maintaining a statewide subrecipient monitoring system, managing statewide construction and coordinating real property acquisition and disposal.

For the last several years, the department has focused on creating a more effective, efficient and focused state government. The cornerstone for the effort has been coordinating and developing a statewide strategic plan with each department developing their own departmental strategic plan. Linked to the departmental strategic plan, each department is also developing a departmental information systems plan. As a result of this planning effort, budgets have been more focused to priority issues and reduced the rate of growth of the state budget.

The Division of Accounts has added new cost accounting modules to the statewide financial system to provide activity-based costing capability and improved reporting of the cost of operations. A new time and attendance system was added to integrate payroll information into the accounting system more efficiently. An executive financial information system is being developed to provide timely and easily-accessible financial information to decision makers. Also, the Division of Accounts is implementing an employee travel and expense system in an effort to bring efficiency to the reimbursement process.

The Department establishes guidelines for state agencies to evaluate their internal control systems. A recent initiative by Resource Development and Support is the centralization of subrecipient monitoring. This will improve efficiency by coordinating the effort so that all subrecipients are monitored and there is no duplication. Also, a Service Provider Registry System (SPRS) was implemented that allows providers of professional services to centrally register as potential service providers to all state agencies.

The state's Local Area Networks (LANs) have been consolidated into one operation group. This allows the state to provide network connections 24 hours a day, utilize fewer staff, and reduce costs. Also, the Department has awarded a contract for the Tennessee Information Infrastructure (TNII). This effort is centered on installing one statewide network that is shared by all governments including state, local, and higher education. This consolidation will allow us the ability to greatly increase our communication functionality and capacity while holding costs stable. Because this purchasing method was used, these telecommunication functions are now available to the private sector in rural communities across the state, thus enhancing economic development.

Other efforts to improve the effectiveness and efficiency of state government include addressing performance based budgeting, one stop shopping, a statewide E-Business strategy, eliminating unnecessary rules and regulations and privatizing state services where appropriate.

As the department looks to the future for improvements, recognition of past successes continue. The state has annually been recognized for excellence in financial reporting, budgeting and information system management. The department has received the Government Finance Officers Association (GFOA's) Award for Excellence in Financial Reporting for the last twenty years for the state's Comprehensive Annual Financial Report and the Distinguished Budget Presentation Award for the state's budget document six times during the 1990's. GFOA also recognized the state with two Awards of Excellence for standardizing reporting requirements for nonprofit recipients of grant funds and the development of the Accounting Manual for Recipients of Grant Funds in Tennessee. The February 1999 issue of Governing Magazine ranked Tennessee's information system technical environment in the top six in the nation. Additionally, in November 1999 Governing Magazine selected Bradley Dugger, head of the Office for Information Resources, as one of ten national 1999 Public Officials of the Year.

FINANCIAL INFORMATION

In developing and modifying the state's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived, and the evaluations occur within the above framework. I believe that the state's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

Budgeting Controls. In addition to internal controls, the state maintains budgetary controls. The objective of these budgetary controls is to ensure compliance with legal provisions embodied in the annually appropriated budget approved by the legislature. Activities of the general fund and special revenue funds (except the Supreme Court Boards, Fraud and Economic Crime and the Dairy Promotion Board, accounted for as special revenue funds) are included in the annually appropriated budget. Budgetary control is maintained at the departmental level by the encumbrance of estimated purchase amounts prior to the release of purchase orders to vendors. Purchase orders which result in an overrun of available balances are not released until budget revisions are approved or additional appropriations are made. Open encumbrances are reported as reservations of fund balance at June 30, 1999.

General Governmental Functions. General governmental functions are accounted for in four governmental funds - the General, Special Revenue, Debt Service and Capital Projects funds. Revenues for general governmental functions totaled \$13.5 billion in 1999. Taxes represented 50.4% of general revenues; it is a slight decrease of .9% in the percentage of the total funding over the prior year from 51.3% to 50.4%. The amount of revenues from various sources and the changes from last year are shown below (expressed in thousands).

<u>Revenue Source</u>	<u>Amount</u>	<u>Percent of Total</u>	<u>Increase (Decrease) from 1998</u>	<u>Percent of Increase (Decrease)</u>
Taxes	\$ 6,783,904	50.4%	\$ 227,519	3.5%
Licenses, fines, fees and permits	191,095	1.4	16,341	9.4
Interest on investments	47,683	.4	11,706	32.5
Federal	5,124,273	38.0	293,074	6.1
Departmental Services	1,282,634	9.5	152,775	13.5
Other	<u>40,155</u>	<u>.3</u>	<u>(7,382)</u>	(15.5)
	<u>\$13,469,744</u>	<u>100%</u>	<u>\$ 694,033</u>	

The 3.5% increase in tax collections above is primarily due to the normal growth in the sales tax of some \$236 million.

Interest on investments increased by \$11.7 million because more cash was available to invest.

Federal revenue for TennCare increased some \$214 million.

Departmental services increased by some \$153 million due to an overall increase in statewide collections for services.

Expenditures for general governmental purposes totaled \$12.4 billion in 1999, a 6.9% increase over the previous year. Changes in expenditures by function from 1998 levels are presented in the following tabulation (expressed in thousands).

<u>Function</u>	<u>Amount</u>	<u>Percent of Total</u>	<u>Increase (Decrease) from 1998</u>	<u>Percent of Increase (Decrease)</u>
General government	\$ 345,746	2.8%	\$ 56,552	19.6%
Education	2,859,303	23.0	127,704	4.7
Health and social services	6,596,034	53.0	501,439	8.2
Law, Justice and public safety	825,010	6.6	82,296	11.1
Recreation and resources development	382,614	3.1	10,495	2.8
Regulation of business and professions	46,346	.4	4,944	11.9
Transportation	1,164,776	9.4	19,240	1.7
Debt service	111,530	.9	10,974	10.9
Capital outlay	<u>105,889</u>	<u>.8</u>	<u>(15,762)</u>	(13.0)
	<u>\$12,437,248</u>	<u>100%</u>	<u>\$ 797,882</u>	

General government increased by \$30 million for miscellaneous appropriations made by the Legislature and \$14 million for criminal justice programs.

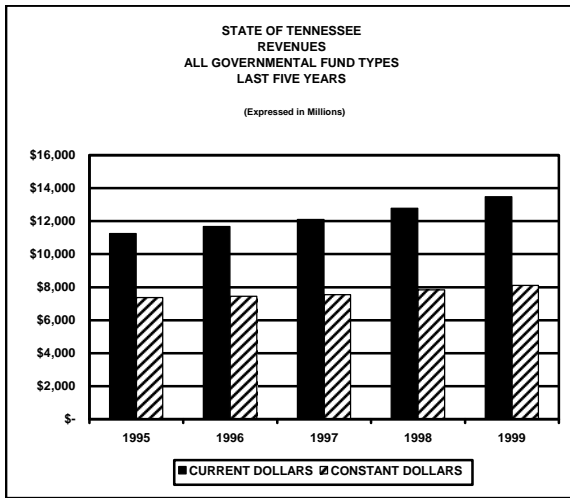
Education increased \$128 million due to the emphasis placed on education as a result of the passage of the Education Improvement Act and increased federal funding.

Health and social services increased \$382 million primarily because TennCare expenditures increased.

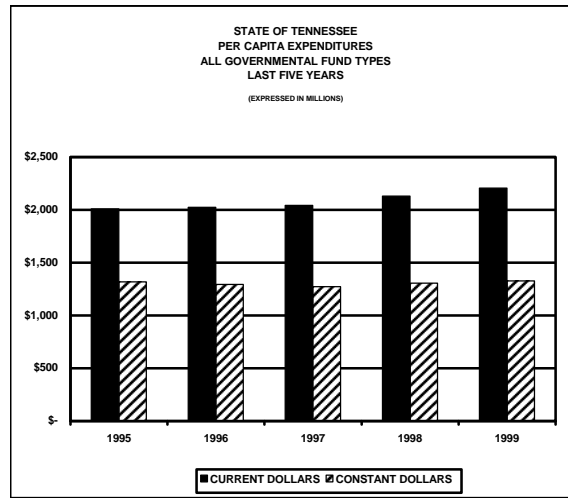
Law, justice and public safety increased \$27 million primarily due to increased expenditures in the Department of Correction and \$20 million increased disaster relief funding.

Debt service increased because the amount of long-term debt increased.

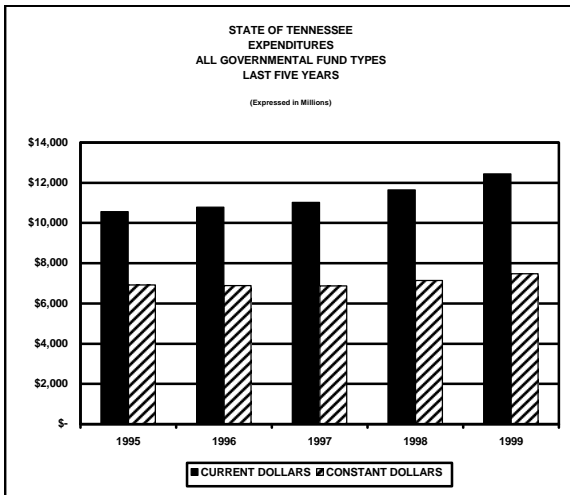
Presented below are tables depicting revenues and expenditures for the last five years on a current dollar and constant dollar basis. In addition, a chart showing per capita expenditures on a current and constant dollar basis is presented.



	1995	1996	1997	1998	1999
CURRENT DOLLARS	\$ 11,250	\$ 11,671	\$ 12,098	\$ 12,776	\$ 13,470
CONSTANT DOLLARS	\$ 7,377	\$ 7,448	\$ 7,547	\$ 7,838	\$ 8,105
PERCENT INCREASE OVER PRIOR YEAR IN CURRENT DOLLARS	8.2%	3.7%	3.7%	5.6%	5.4%
PERCENT INCREASE OVER PRIOR YEAR IN CONSTANT DOLLARS	5.0%	1.0%	1.3%	3.9%	3.4%



	1995	1996	1997	1998	1999
CURRENT DOLLARS	\$ 2,009	\$ 2,025	\$ 2,043	\$ 2,129	\$ 2,207
CONSTANT DOLLARS	\$ 1,317	\$ 1,293	\$ 1,274	\$ 1,306	\$ 1,328
PERCENT INCREASE OVER PRIOR YEAR IN CURRENT DOLLARS	8.6%	0.8%	0.9%	4.2%	3.7%
PERCENT INCREASE OVER PRIOR YEAR IN CONSTANT DOLLARS	5.4%	-1.9%	-1.4%	2.5%	1.7%



	1995	1996	1997	1998	1999
CURRENT DOLLARS	\$ 10,558	\$ 10,789	\$ 11,026	\$ 11,639	\$ 12,437
CONSTANT DOLLARS	\$ 6,923	\$ 6,885	\$ 6,878	\$ 7,140	\$ 7,483
PERCENT INCREASE OVER PRIOR YEAR IN CURRENT DOLLARS	10.3%	2.2%	2.2%	5.6%	6.9%
PERCENT INCREASE OVER PRIOR YEAR IN CONSTANT DOLLARS	7.0%	-0.6%	-0.1%	3.8%	4.8%

General Fund Balance. The fund balance of the general fund decreased slightly by \$30.6 million in 1999.

Proprietary Funds. Combined operating results for the State's enterprise funds remained strong in 1999 and were paced by the insurance activities for local government and local government teacher employees. Operating revenues were \$177.1 million, an increase of \$18.9 million over 1998. Operating expenses increased to \$167.0 million from \$140.3 million the previous year.

Combined operating results for the State's internal service funds also remained strong in 1999. Operating revenues and expenses for these cost-reimbursement agencies aggregated \$578.3 million and \$599.5 million, respectively, as compared to 1998 amounts of \$559.4 million and \$551.0 million. The principal internal service operations provide data processing services, third party liability claims processing, agency housing, and employee group insurance.

Pension Plan. Total assets of the State's pension trust fund reached \$23.1 billion at June 30, 1999. The net assets held in trust for pension benefits total \$22.8 billion.

Debt Administration. At June 30, 1999, the State had a number of debt issues outstanding. These issues included \$927.6 million of general obligation bonds, \$23.6 million of enterprise fund debt with state commitment, and \$135.3 million of internal service fund debt with state commitment. Tennessee continues to receive excellent bond ratings from Moody's Investors Service (Aaa), Standard and Poor's Corporation (AAA), and Fitch Investors Service, Inc. (AAA) on general obligation bond issues, reflecting our long-standing record of sound financial management. Under current state statutes, the state's general obligation bonded debt issuances are subject to an annual legal debt service limitation based on a pledged portion of certain current year revenues. As of June 30, 1999, the state's annual legal debt service limit of \$421.3 million was well above the debt service required of \$125.9 million, with a legal debt service margin of \$295.4 million. Debt per capita equaled \$187, and the ratio of net general long-term bonded debt to assessed property valuation was 1.4 percent.

Cash Management. The State Treasurer has pursued an aggressive cash management and investment program. One aspect of this, which we believe is unique to Tennessee, is our direct access into the Federal Reserve wire system. Through the State Trust of Tennessee, wire services in the federal system are available via a terminal located in the State's investment offices. This provides the State flexibility in investing and concentrating cash balances and pension fund assets, and in redeeming warrants and checks issued against the Treasury. During fiscal year 1999, uncommitted State funds were invested in short-term collateralized deposits as follows (averaged): certificates of deposit (42%); repurchase agreements (4%); commercial paper (33%); U.S. Treasuries (20%); and money market accounts (1%). The composite average yield on these investments was 5.22%, down from 5.64% last year.

Risk Management. In 1989, the state initiated a loss prevention program. A loss prevention specialist has been employed to assist the state in analyzing the underlying cause of losses and in recommending measures to minimize the reoccurrence of similar losses. All state property is insured under an all risk policy for full value, with no upper limit on aggregate claims for losses. The insurance policy has an annual \$5 million aggregate deductible which is covered by \$5 million of the state designation for casualty losses.

OTHER INFORMATION

Securities and Exchange Commission Disclosures The State Funding Board, the Tennessee State School Bond Authority, and the Tennessee Local Development Authority have each entered into Continuing Disclosure Undertakings with respect to certain debt issues. These Undertakings were made for the benefit of the holders of the debt pursuant to U.S. Securities and Exchange Commission Rule 15c2-12. The issuers have covenanted to provide certain Annual Financial Information, including audited financial statements as well as certain additional financial and operating data. With the exceptions of information related to Tennessee Consolidated Retirement System and of certain local government financial information related to the Tennessee Local Development Authority provided to the Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) under separate cover, financial and operating data required pursuant to the Undertakings is located in this Comprehensive Annual Financial Report. The reader should use the index located at the end of this report to identify the specific page where the information is presented.

Independent Audit. State statutes require an annual audit of all fund types and account groups of the State. The accompanying financial statements have been examined by the Office of the Comptroller of the Treasury, Division of State Audit. Their examination was conducted in accordance with generally accepted government auditing standards, and their opinion appears elsewhere herein.

In conjunction with this examination, the Division of State Audit conducted an organization-wide audit as described in the Single Audit Act of 1984 as amended and Office of Management and Budget Circular A-133, Audits of State, Local Governments, and Non-Profit Organizations. The audit included tests of compliance with applicable federal laws and regulations as well as a study and evaluation of internal controls, including internal accounting and administrative controls used in administering federal financial assistance programs. The results of this single audit are published under separate cover by the Division of State Audit.

Awards. The Government Finance Officers Association of the United States and Canada (GFOA), awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Tennessee for its Comprehensive Annual Financial Report for the year ended June 30, 1998. This is the twentieth consecutive year that the state has received this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement Program requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

In addition, the Tennessee Consolidated Retirement System has received this award for eleven consecutive years for its Comprehensive Annual Financial Report.

Acknowledgments. The preparation of the comprehensive annual financial report was made possible by the dedication of the entire staff of the Division of Accounts in the Department of Finance and Administration. This report could not have been prepared without the cooperation of all state agencies and branches.

Respectfully submitted,

/s/ John D. Ferguson

John D. Ferguson, Commissioner
Department of Finance and Administration

JDF/jm



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
STATE CAPITOL
NASHVILLE, TENNESSEE 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

December 10, 1999

To the Members of the General Assembly
of the State of Tennessee
and
The Honorable Don Sundquist, Governor
of the State of Tennessee

Ladies and Gentlemen:

In accordance with Section 4-3-304, Tennessee Code Annotated, transmitted herewith is the auditor's report on the Comprehensive Annual Financial Report of the State of Tennessee for the fiscal year ended June 30, 1999.

Respectfully,

/s/ John G. Morgan

John G. Morgan
Comptroller of the Treasury

JGM/jm